

22

CONSUMER RIGHTS AND MULTILEVEL MARKETING (PYRAMID) SCHEMES

§ 22. 1. Introduction

This consumer rights chapter describes the possible civil and criminal penalties for entering into a pyramid scheme. It contains the following sections:

§ 22. 2. Pyramid Schemes Can Be Illegal

§ 22. 3. The Statute Prohibiting Pyramid Schemes

§ 22. 4 Why “Gifting” Pyramids Are Illegal

§ 22. 2. Pyramid Schemes Can Be Illegal

The Maine Legislature at 17 M.R.S.A. § 2305 has enacted a very strict civil and criminal statute prohibiting many forms of multi-level marketing businesses such as pyramid clubs. If a multi-level marketing scheme is in violation of this statute, it is illegal for that company to do business in the State of Maine. Violation of this statute can be a civil Unfair Trade Practice and a *Class E crime*.

Pyramid schemes are inherently deceptive and contrary to public policy. The deception arises because the market can quickly become saturated and the seemingly endless chain can rapidly end. Consequently, many participants will never even recoup their investments, let alone make a profit. (*See In re Holiday Magic, Inc.*, 84 F.T.C. 748) (Oct. 15, 1974). For example, the chart below shows what happens when the first seller sells six memberships and, in turn, each of the six buyers sells six more, and the cycle is repeated:

Participants

1

6

36

216

1,296

7,776

46,656

279,936

1,679,616

10,077,696

60,466,176

362,797,056

(Exceeds U. S. Population)

2,176,782,336

13,060,694,016

(Exceeds World Population)

Even if the pyramid scheme involves the sale of a specific consumer product (e.g., motivational tapes), if this product is sold to persons who are also purchasing the right to membership in the pyramid, then Maine law can still be violated.¹ In general, be very leery of any multi-level marketing scheme in which you must purchase the product being sold in order to become a seller in the organization.

Pyramid schemes, in general, have been held to be inherently fraudulent because they must eventually collapse. *Webster v. Omnitrition Intern., Inc.*, 79 F. 3d 676, 781 (9th. Cir. 1996); *SEC v. International Loan Network, Inc.*, 968 F. 2d 1304, 1309 (D.C. Cir. 1992); *Illinois ex rel. Fahner v. V. Walsh*, 461 N.E. 2d 78 (Ill. 1984) (holding pyramid scheme violated Illinois Unfair Trade Practice Consumer Law, which is identical to Maine's Unfair Trade Practice Act, 5 M.R.S.A. § 207).

Violation of this pyramid statute is also an unfair trade practice under 5 M.R.S.A. §§ 207.² If you have been injured by a multi-level marketing scheme, you may be able to go to court and receive your money back and your attorney fees (5 M.R.S.A. § 213). See Chapter 3, The Maine Unfair Trade Practices Act.

¹ See *People Ex Rel. Hartigan v. Dynasty System*, 471 N.E.2d 236, 241 (Ill. 1984) (pyramid scheme is illegal when benefits to participants are primarily based on adding new members and not on volume of goods sold).

² See *State of Maine v. Bigsmart.Com*, No. CV-00-82 (Me. Sup. Ct., Kenn. Cty. 2001) (Consent Decree in which Court imposed a \$40,000 civil penalty on multi-level "internet mall" and required it to be registered as a Transient Seller); *State of Maine v. Club Atlanta Travel, Inc.*, No. CV-97-101 (Me. Sup. Ct. Kenn. Cty., 1997) (Consent Decree in which court imposed on a multi-level marketing organization a civil penalty of \$5,000 and required it to be registered as Transient Seller).

§ 22. 3. The Statute Prohibiting Pyramid Schemes

The Maine criminal statute which prohibits pyramids reads as follows:

17 M.R.S.A. § 2305.

Multi-level distributorships, pyramid clubs, etc., declared a lottery; prohibited; penalties

The organization of any multi-level distributorship arrangement, pyramid club or other group, organized or brought together under any plan or device whereby fees or dues or anything of material value to be paid or given by members thereof are to be paid or given to any other member thereof who has been required to pay or give anything of material value for the right to receive such sums, with the exception of payments based exclusively on sales of goods or services to persons who are not participants in the plan and who are not purchasing in order to participate in the plan, which plan or device includes any provision for the increase in such membership through a chain process of new members securing other new members and thereby advancing themselves in the group to a position where such members in turn receive fees, dues or things of material value from other members, is declared to be a lottery, and whoever shall organize or participate in any such lottery by organizing or inducing membership in any such group or organization shall be guilty of a misdemeanor, and upon conviction thereof shall be punished by a fine of not more than \$5,000 or by imprisonment for not more than 11 months, or by both.

A violation of this section shall constitute a violation of Title 5, Chapter 10, Unfair Trade Practices Act.

§ 22. 4. Why “Gifting” Pyramids Are Illegal

This office has received many calls from people who have participated in one of the “gifting” pyramids that have swept over the state of Maine over the last 3-years. These pyramids have taken such names as **Changing Lives, NASCAR, A Woman’s Project** and other names. In our opinion, these “gifting” schemes are illegal pyramids. Only the persons who reach the top of the pyramid will receive money. Everyone else will lose their money because the pool of possible recruits will quickly run dry. Further, organizers of these schemes often use deceptive sales pitches to entice new recruits (for example, “It’s perfectly legal;” or “It’s a gift so you do not owe taxes;” or “If you ever want to drop out, we guarantee that you will get back your money.”

The Attorney General has now filed civil Unfair Trade Practice law suits against some of the participants of all of the above “gifting” pyramids.³ If you lost money due to an illegal pyramid and the person you gave your money to refuses to return it you should consult with a lawyer in order to see whether you should go to court and demand your money back.

³ *State of Maine v. Beauchesne, et al.*, No. CV-01-03 (Me. Super. Ct., Kenn. Cty., 2000); *State of Maine v. Abrams, et al., d/b/a A Woman’s Project* No. CV-02-88 (Me. Super. Ct., Kenn. Cty. 2002); and *State of Maine v. John Neddeau (NASCAR)*, CV-01-184 (Me. Super. Ct., Kenn. Cty. 2002).

A. The Gifting Pyramid Called “A Woman’s Project”

The Attorney General believes “A Woman’s Project” AWP is an illegal “gifting” pyramid. Here is our analysis of this pyramid and why we believe it is illegal. A Woman’s Project is similar to other “gifting” pyramids, such as Changing Lives and NASCAR.

On April 29, 2002 the Maine Attorney General filed in Maine Superior Court a civil Unfair Trade Practice Action against 29 Defendants who participated in A Woman’s Project. The Attorney General’s goal in this litigation is to obtain a civil injunction against the continued operation of A Woman’s Project and to obtain restitution (money back) for some of the persons who were persuaded to pay money in order to join this pyramid scheme.

B. How “A Woman’s Project” Is Organized

A Woman’s Project is a women-only, multi-level organization in which participants move up a hierarchy as new recruits are persuaded to occupy the lower positions. In order to join A Woman’s Project new recruits are typically required to contribute the sum of \$5,000 to a senior member. By contributing \$5,000 to A Woman’s Project a new recruit herself then becomes eligible to move up the hierarchy and, assuming additional recruits are persuaded to join, to eventually reach the top position and receive \$40,000.

A Woman’s Project uses a dinner party analogy to explain to recruits how its fundraising scheme works. Each new recruit typically gives \$5,000 and is thereby placed at the “Appetizer” level of the “Dinner Table.” When eight new recruits have been persuaded to join A Woman’s Project, they each give \$5,000 to a participant who has reached the “Dessert” level, the highest position at the “Dinner Table.” As the new recruits work their way up the hierarchy, they move from “Appetizer” to “Soup and Salad,” to “Entrée,” and, finally, “Dessert.”

This “Dinner Table” is actually a four level, three step pyramid with one “Dessert” at the top, two “Entrees” beneath the “Dessert” position, four “Soup and Salads” beneath them, and eight newly recruited “Appetizers” at the bottom. When the “gifting” process is complete and the “Dessert” leaves the table with \$40,000, the remainder of the table splits, everyone advances up in rank and two new “Dinner Tables” are formed, each containing a new “Dessert” and six other participants, all of whom need to actively seek 8 new “Appetizer” recruits, with the result that new pyramid tables will continue *ad infinitum* or so everybody is led to believe. Thus, A Woman’s Project is not a singular, ever-expanding pyramid, but rather one which spawns a chain of multiple ongoing pyramids, each of which is linked to its predecessor.

Fundraising schemes such as A Woman’s Project are illegal in Maine and most other states because they are inherently deceptive and, for many participants, a loss of funds is guaranteed. As the chart below shows, millions of new recruits would be required to provide this voracious, amoeba-like pyramid with the members necessary for it to continue to divide and exist. Consider the mathematical computations and the geometric progression demonstrated by the following A Woman’s Project chart:

Levels of Progression	New “Appetizer” Recruits Necessary for Each Newly Created Dinner Table to Split and Continue	Total Paying Dinner Party Participants
0	7 (non paying original organizers)	0
1	8 (new recruits necessary to continue)	8
2	16	24
3	32	56
4	64	120
5	128	248
6	256	504
7	512	1016
8	1024	2040
9	2048	4088
10	4096	8184
11	8192	16,376
12	16,384	32,760
13	32,768	65,528
14	65,536	131,064
15	131,072	262,136
16	262,144	524,280
17	524,288	1,048,568
18	1,048,576	2,097,144
19	2,097,152	4,194,296
20	4,194,304	8,388,608

The seven original organizers, of course, pay no money, and are never at risk. Moreover, they receive immediate profits as A Woman’s Project grows in its early stages when recruits are readily available. In addition, if the early participants rotate their names and initiate several other dinner parties, their rewards would multiply well before the pool of available recruits dries up. For the original eight *investing* recruits (\$5,000 each) to reach the “Dessert” apex of the pyramid, the dinner party must progress three levels and 48 new recruits must join, making a total of 56 participants.

Moreover, in order for these eight original investing organizers to reach the “Dessert” level and to be paid, the dinner party must progress another level and 64 new founders must join the eight dinner parties headed by these eight “Desserts.” At this level, a total of 120 paying “Appetizers” will have had to participate. Although sufficient possible recruits may be available at these early stages of the program, the pool of available people rapidly dissipates as the program progresses.

As the chart above demonstrates, at the 20th level 4,194,304 new investing recruits (“Appetizers”) would be required in order for all previous “Desserts” to be paid and retire; and at that level a total of

8,388,600 investing “Appetizers” will have participated. Just to advance one additional level, these 20th level “Appetizers” would require an additional 8, 388,608 new recruits, thus making a total of 16,777,208 participating “Appetizers.”

In addition, consider the staggering number of new recruits which would be necessary for all of these 20th level “Appetizers” to advance to the “Dessert” position. Obviously, such a pool of persons would more than exhaust even the largest of population centers in the United States. Thus, these schemes inevitably fail and because of this, they are made *malum prohibitum* throughout most of the United States and certainly in Maine.

C. Additional Misrepresentations By A Woman’s Project

The Attorney General also believes that A Woman’s Project has made specific misrepresentations that are so unfair and deceptive as to violate the Maine Unfair Trade Practices Act. Included among these misrepresentations were the following claims:

- (1) New recruits were assured A Woman’s Project was in all ways legal.
- (2) New recruits were promised they would receive back their \$5,000 if they ever decided to no longer be a member of A Woman’s Project.
- (3) New recruits were assured that any income they received if they were to reach the “Dessert” level was a “gift” and therefore not be subject to income taxes.